Statement Regarding the National Charter Final Rule by The Honorable Michael M. Reyna Chairman and CEO Farm Credit Administration October 11, 2001

I would like to open my comments with a quote from Thomas Jefferson:

"I am certainly not an advocate for frequent and untried changes in laws and constitutions. I think moderate imperfections had better be borne with; because, when once known, we accommodate ourselves to them and find practical means of correcting their ill effects. But I know also that laws and institutions must go hand in hand with progress of the mind. As that becomes more developed, more enlightened, as new discoveries are made, new truths disclosed and manners and opinions change with the circumstances, institutions must advance also and keep pace with the times. We might as well require a man to wear still the coat which fitted him when a boy as civilized society to remain ever under the regimen of their barbarous ancestors."

The regulation before us today for consideration is not the first, but rather the most recent, effort to respond to a persistent safety and soundness problem that faces the Farm Credit System: the fact that it is essentially a single sector lender. This is not a new finding. In fact, it was recognized in a report from the Treasury Department over ten years ago. And, it has been highlighted by various Wall Street rating agencies for some time.

The mid-1980's was the last time that agriculture fell upon particularly hard times. Agricultural land prices dropped, and so did the fortunes of farmers and lenders alike. With a dose of strong medicine in the form of an arms-length safety and soundness regulator and good faith efforts on the part of Farm Credit lenders, the Farm Credit System has rebounded and returned to financial health. Today, the capital level of the Farm Credit System is at an all time high and earnings are strong. All those who care about the System rightfully can be proud of its current financial condition, but we should not become complacent.

In the face of disasters and low commodity prices, agriculture has received strong financial support from Congress in recent years. Farmers, ranchers, cooperatives and rural communities have benefited from this support; but so too have their lenders, including the Farm Credit System. All those who care about agriculture can take great solace knowing that Congress has provided financial support in the past, but we should not become complacent.

The events of recent days are a sad and painful reminder to each of us that while we all like to hope for the best, we must be prepared for the worst. Lending can be a risky business, and agricultural lending even more so. The Farm Credit Administration, through its regulations, has long prescribed the specific geographic boundaries (territories) of System institutions. This regulatory scheme effectively insulates System institutions from competition with other System institutions, though not necessarily from other lenders. The scheme, however, limits a System institution's ability to diversify its portfolio on a geographic and commodity basis, which is particularly important given agriculture's vulnerability to the weather, pests and other natural disasters.

Congress, in establishing the Farm Credit System, recognized that "a prosperous and productive agriculture is essential to a free nation" and designed the System as a means to achieving certain objectives, including to:

- Improve the income and well-being of American farmers and ranchers by furnishing sound adequate and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations; and

- Encourage farmer and rancher participation in the management, control and ownership of a permanent system of credit for agriculture, which is responsive to all types of agricultural producers having a basis for credit;

Furthermore, Congress set forth its policy that eligible borrowers receive the greatest practicable benefit from equitable and competitive interest rates consistent with the institution's need to cover its costs as well as retain earnings for business purposes.

Congress also specifically directed System institutions to develop programs that serve young, beginning and small farmers and administer distressed loans to farmers with the objective of using loan guarantee programs of the old Farmers Home Administration and other restructuring measures, including participating in interest rate buy-down programs that are federally or state funded, and other federal and state sponsored financial assistance programs that offer relief to financially distressed farmers, as alternatives to foreclosure.

These congressional policies, objectives and directives are important because they apply, not to all agricultural lenders, but solely and specifically to the Farm Credit System. And most significantly, these policies, objectives and directives speak directly to the public policy mission of the Farm Credit System as a government sponsored enterprise (GSE). By law, the System, unlike other lenders, cannot walk away from agriculture.

Congress created this agency, the Farm Credit Administration, as the arms length safety and soundness regulator of the System. Congress relies on FCA to have a vigorous financial examination program and to make sure that the System adheres to its public policy mission as a GSE. Congress, however, also expects FCA to interpret the Farm Credit Act through common sense policies and regulations.

Along with our basic mission, Congress has provided the Farm Credit Administration with clear direction to "continue the comprehensive review of regulations governing the Farm Credit System to identify and eliminate … consistent with law, safety and soundness … all regulations that are unnecessary, unduly burdensome or costly, or not based on law."

We have tackled the safety and soundness problems posed by narrow geographic territories because we are mindful of our responsibility as a regulator and the specific congressional directives to review our regulations.

As stated earlier, the rule before us for consideration today is not the first effort, but rather the most recent effort, to respond to these concerns. Earlier attempts focused on a borrower's ability to do business with the System lender of their choice. It is true that the "customer choice" approach — which, of course, is not before us today — could have, over time, led to System institutions having more diversified loan portfolios. In my judgment, however, that proposed rule was not a very responsible regulatory approach for this agency to take for a whole host of reasons.

As we have heard from staff, the rule before us for consideration today has three basic components that:

- Allow System institutions to seek expanded geographic charters;

- Create local service areas and require System institutions to serve them; and

- Enhance the business planning activities of System institutions.

This rule has engendered more discussion, debate and comment and had more public scrutiny than quite possibly any other rule to come before this agency in the last decade. In my judgment, the focus on the rule has been good; it has been positive and it has been helpful. Healthy public debate on important and critical public policy issues is always good. In fact, it is an essential component to good decision-making on matters of public policy.

In preparation for today's public meeting, I reviewed the comment letters on this rule. I want to take this opportunity to thank the more than 1,500 people who cared enough to comment. The vast majority of comments were thoughtful and provided great insight into the rule's likely impact.

I believe that the business planning aspects of this rule make good sense. Many comment letters addressed the local service area aspect of the rule given the System's important public policy mission. Indeed, it is very important for the System to remember its mission as a GSE. This focus on mission is valuable, however, whether or not the specific local service area requirement of the rule is adopted.

The critical element of the rule before us today — and the element that attracted the most comment and attention — is the provision that allows System institutions to seek expanded geographic charters. My reading of the comment letters suggests that there is serious concern regarding the potential impact expanded geographic charters would have on the cooperative nature of the System and the fact that the System is jointly and severally liable for its debt.

At this point I believe it is important to recall part of Thomas Jefferson's quote: "I think moderate imperfections had better be borne with; because, when once known, we accommodate ourselves to them and find practical means of correcting their ill effects."

Farmers have always known that agriculture is about economics. Continuing low prices combined with rising costs has today's best agricultural producers operating on a thin margin; and some producers wouldn't be in business at all without ongoing financial support from Congress.

Given the serious concerns raised regarding the potential impacts of expanded geographic charters, I do not believe it would be prudent to introduce a major structural change to the System without further study, and particularly in light of the fact that the economics of agriculture is unlikely to improve anytime in the near future.

Notwithstanding my opinion on the expanded charter portion of the rule before us, I do believe we could proceed with enhancing the business planning aspects of System institutions' activities and, consistent with many of the comments we received, remind the System of its important public policy mission generally, rather than specifically through the establishment of individual local service areas.

I want to issue a final word of caution because … after all … complacency is a risk.

I would note that my concern regarding commodity concentrations in System institutions that are tied to narrow geographic territories remains with me. Hence, I want to encourage System institutions to use sound risk management strategies during these uncertain times and to take steps, consistent with law and regulation, to diversify the agricultural commodities in their portfolios, and otherwise reduce certain risk exposures.